91-973

No. 91-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

STATE OF ILLINOIS, ex rel. ROLAND W. BURRIS, Attorney General of the State of Illinois,

Petitioner,

v.

PANHANDLE EASTERN PIPE LINE COMPANY, A Delaware Corporation,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

This Petition presents the following questions:

1. Does a regulated monopolist's use of a "bottleneck" facility to foreclose competition on the merits in a related unregulated market that results in the consumer's choice being limited to only the monopolist's inferior product constitute a violation of the antitrust laws?

2. Does a regulated monopolist's tying of its inferior product in a related unregulated market to the use of its "bottleneck" facility violate the antitrust laws?

3. Does a regulated monopolist's refusal to deal with a competitor in a related unregulated market, who is also a customer of the monopolist's "bottleneck" facility, violate the antitrust laws?

4. Whether a regulated monopolist that abuses its derivative monopoly power in a related unregulated market where it does not have a competitive advantage on the merits has a recognized business justification under the antitrust laws if the monopolist's actions were motivated by a desire to protect its corporate profits and were put into effect by adherence to a filed tariff?

5. Whether the proper focus of an antitrust analysis is to determine whether the challenged conduct promotes competition and maximizes consumer satisfaction or instead is to decide the fairness of requiring a regulated monopolist to compete in a related unregulated market where it does not have a competitive advantage on the merits?

LIST OF PARTIES

The caption of this petition identifies all parties in the lower court, except that the Attorney General of the State of Illinois when this matter was filed was Neil F. Hartigan.

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CASES

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PETITION FOR WRIT OF CERTIORARI

Petitioner State of Illinois respectfully requests that a writ of certiorari issue with respect to the judgment of the United States Court of Appeals for the Seventh Circuit entered in this case on June 4, 1991.

OPINIONS BELOW

The opinion of the court of appeals is reported at 935 F.2d 1469 (7th Cir. 1991). It is reprinted in the appendix ("App.") at page A-1. The district court's opinion is published at 730 F. Supp. 826 (C.D. Ill. 1990) and is reprinted at page B-1. The court of appeals' order denying the State of Illinois' petition for rehearing is not reported and is reprinted at page C-1.

JURISDICTION

The court of appeals entered judgment on June 4, 1991. It denied a timely petition for rehearing on September 9, 1991. This Court has jurisdiction to review the judgment by writ of certiorari under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The statutes involved are 15 U.S.C. §§ 1 and 2, 15 U.S.C. § 3431(a)(1) and (a)(2), 15 U.S.C. § 3371(a)(1), and Ill.Rev.Stat. ch. 38, § 60-3(3)-(4), and Ill.Rev.Stat. ch. 38, § 60-11.

STATEMENT OF THE CASE

A. The Parties and the Market Setting.

Plaintiff-petitioner, State of Illinois ("State"), filed this action in both its sovereign *parens patriae* capacity and in its proprietary capacity as a natural gas consumer. Acting in its proprietary capacity, the State has been certified to represent a class of approximately 300,000 residential and commercial gas consumers residing in the Central Illinois market, who were exclusively served by Panhandle Eastern Pipe Line Company ("Panhandle").

1. Panhandle's strategic dominance in the Central Illinois gas sales market.

Panhandle is in the business of transporting and selling gas. From at least 1983 through 1987, Panhandle completely dominated the markets in both the transmission and sale of gas into the Central Illinois area. As the owner of the only interstate pipeline authorized by regulation to serve Central

Illinois, Panhandle was the exclusive provider of gas transmission services to that area. No gas could be sold in Panhandle's service area unless Panhandle approved its transmission on Panhandle's pipeline.

Prior to 1983, because there were no competitors in the sale of gas to the Central Illinois market, Panhandle sold 100% of the gas purchased by consumers within that market. In its gas sales operation, Panhandle entered into contracts of variable duration to purchase gas from certain producers and its affiliate Trunkline. Panhandle resold that gas to three regulated local distribution companies, ("LDCs") that distributed the gas through a grid of pipes to the LDCs' customers' homes or places of business. The structure of the sales and distribution market was relatively simple: the LDCs were captive to Panhandle, and the LDCs' residential and commercial consumers were captive to both Panhandle and the LDCs.

Panhandle designed the tariff and service agreements that governed its relationship with the LDCs. Although its tariffs were initially approved by FERC, Panhandle at all times retained the discretion to modify its tariff structure.

When competitively priced gas became available in the early 1980s, Panhandle retained its 100% share of the gas sales to captive consumers by denying potential competitors in gas sales access to its pipeline. From 1983 through 1987, captive consumers were forced to purchase all of their gas requirements from Panhandle at its supercompetitive prices.

2. Regulatory changes led to the availability of independent producer gas by at least 1983.

In 1978, Congress enacted the Natural Gas Policy Act ("NGPA"), 15 U.S.C. §§ 3301-3432 (1988), and deliberately proceeded to stimulate the production of gas supplies by replacing the existing price regulated market with a market where price was set by competition. Congress created a whole

new category of gas not "committed or dedicated to interstate commerce" prior to 1977. A seller of "new gas" could engage in the first sale of such gas without becoming a "natural gas company" subject to the provisions of the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717-717(w) (1988), or the Federal Energy Regulatory Commission's (FERC) jurisdiction. 15 U.S.C. §§ 3431 (a)(1)-(2). As a result, these sales functioned outside of the existing contractual and regulatory arrangements that continued to govern the sale of "old gas".[1] The NGPA substituted competition for price regulation as the only protection for consumers.

Deregulation worked. In order to compete in the gas sales market, independent producers made substantial capital investments to develop new sources of gas supplies. As a result, an active market evolved between independent producers vying to sell gas to consumers either directly or through the LDCs. By 1983, the price of "new gas" had fallen substantially below the ceiling prices established by the NGPA and therefore was unconstrained by regulation.

B. Panhandle's Conduct Foreclosed Competition On The Merits In The Gas Sales Market And Forced Captive Consumers To Pay A Supercompetitive Price For Gas.

1. Panhandle's gas purchasing practices after passage of the NGPA.

By the early 1980s it became clear to Panhandle that the NGPA had resulted in large volumes of gas becoming available. At the same time, Panhandle was warned by its LDC

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[1] New gas was exempt from wellhead price controls (except for the NGPA established ceiling prices in effect until 1985), and from FERC's regulations and requirements governing natural gas companies engaged in the sale or transportation of natural gas. 15 U.S.C. §§ 717(c)-717(i).

customers that Panhandle was overestimating their level of demand for gas. Demand had decreased because alternate fuels, such as fuel oil, had become cost competitive with gas, and large users of gas suddenly found it cost effective to switch to those alternate fuels. Panhandle ignored these two factors and initiated an aggressive gas purchasing program, entering into long term contracts to buy large volumes of new gas at NGPA ceiling prices.

Panhandle built no protection for consumers into these contracts. Almost all of Panhandle's contracts after 1978 contained take or pay clauses which required it to pay for a specified quantity of gas at the ceiling price, even if Panhandle was not immediately able to resell the gas. Panhandle, however, ignored industry practice by not including "market-out" clauses in its take or pay contracts. Under these clauses, Panhandle would have had the right to opt out of its take or pay obligations if the competitive price of gas fell below the contract price, and the producer declined to sell its gas at the competitive price. In such a case, Panhandle would not be required to either "take" or "pay."

From 1980 through at least 1985 Panhandle's most expensive source of gas was its affiliate Trunkline. Because Trunkline faced competition in its service area it was unable to sell its high priced gas. Beginning in at least 1982, in order to help Trunkline, Panhandle chose to dramatically increase its purchases of Trunkline's expensive gas, resulting in a decrease in Panhandle's takes from its other contract-producers. It was these purchases from Trunkline that caused the take or pay "problem" Panhandle faced in 1983. If Panhandle had chosen to purchase the less expensive gas available from independent producers instead of buying from Trunkline, Panhandle's take or pay exposure to its on-system producers would have remained the same, but the price of its gas to consumers would have been at least $1.00 per mcf

lower. Instead, for the years 1983 through 1985 Panhandle's purchases from Trunkline totalled $1.5 billion, and accounted for, on average, approximately 25% of Panhandle's entire gas purchases in those years.

2. Panhandle's denial of access to potential competitors in the sale of gas.

As the price of Panhandle's gas rose, LDCs in the Central Illinois market successfully negotiated with independent producers to purchase "new gas" for their system supplies. In early 1983 these LDCs began to make repeated requests of Panhandle that it ship the "new gas" pursuant to the IT tariff Panhandle had on file. Under the terms of its IT tariff, Panhandle could ship new gas on behalf of LDCs' system supplies without bringing the sale or transportation within FERC's jurisdiction. 15 U.S.C. § 3371(a)(1). Panhandle, without explanation, refused to ship the gas.

In May, 1984, Panhandle asserted for the first time that it would ship the new gas but only if the LDCs agreed to relinquish their status as G tariff customers. Panhandle's tariff and service agreements limited G tariff status to LDCs who did "not purchase gas from any other natural gas company, as defined in the Natural Gas Act." However, Congress decreed that for purposes of the sales and transportations of new gas, independent producers were not natural gas companies under the NGA. These transactions, therefore, were outside the scope of the G tariff's provisions, and Panhandle knew it. In December, 1982, a Panhandle attorney wrote a memorandum stating "where the producer is only selling certificate deregulated gas (or "new gas") . . . [p]robably the better view is that such purchases would be permissible under the [G] tariff." Another indication of Panhandle's knowledge was its testimony filed with FERC in the summer of 1983, which provided that the G tariff "*only* precludes purchases by

a General Service (G tariff) customer from another interstate pipeline supplier."

By ignoring the NGPA and insisting on the applicability of the G tariff to these transactions, Panhandle stymied the efforts of LDCs to purchase competitively priced gas. Under Panhandle's interpretation, if a LDC purchased one molecule of independent gas it would lose its G tariff status and incur a penalty as high as $150 million. Panhandle's uneconomic penalty made the cost of purchasing the new gas prohibitive.

3. Panhandle's segmentation of the gas sales market.

Due to declining fuel oil prices, Panhandle's fuel switchable customers threatened to leave the Panhandle system unless allowed to obtain competitively priced gas. To keep these customers on system, Panhandle could either have dropped the price of its gas or allowed them to deal with the independent producers. Regulation required uniformity in Panhandle's gas prices to its customers. A lowering of price, therefore, would have been applicable to all customers, including captives, and Panhandle would have lost its ability to dump its higher priced contract gas. Rather than lowering its prices, Panhandle elected to segment the gas sales market to permit the fuel switchables to deal with the independent producers but not the captives. Segmentation allowed Panhandle to successfully bleed off the competitive pressure from its fuel switchable customers; Panhandle was able to keep its transportation revenues high, maximize its gas sales to noncaptives, and continue to sell 100% of the captives' gas requirements at its supercompetitive price.

4. Panhandle's evasion of regulatory price restraints in its transportation rate.

Panhandle was constrained by regulation from increasing the nominal price charged for transportation to its full

monopoly level.[2] By limiting the price it could charge for transportation, regulation prevented Panhandle from fully exploiting its monopoly power in transportation to its captive consumers. Because these consumers lacked any good alternative to gas, and any alternative to Panhandle for transporting that gas, Panhandle could pass on its gas acquisition costs without so reducing throughput levels as to make the passing on of its gas costs unprofitable. What Panhandle did was use its residual monopoly power in transportation to force the captive consumers to buy its high-priced gas. The extra cost of the gas was effectively an increase in the price charged for transportation: the only reason the captive consumers bought the high-priced gas was because they were forced to do so in order to buy the transportation at the regulated nominal price. By smuggling these profits into the gas cost component of its rates, Panhandle was able to evade the control of regulators.

5. The effects of Panhandle's conduct on the captive consumers, its gas sales competitors and on Panhandle itself.

From 1983 through 1986 Panhandle's gas ranged between a \$1.00 to \$1.30 per mcf above the competitive market price of gas. In 1984, Panhandle's gas was the second

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[2] Panhandle's bundled wholesale rate to its customers consisted of two parts: the marginal and fixed transportation costs component and the gas costs component. The transportation costs account for only about 15 percent of the wholesale gas rate, while gas costs account for approximately 85 percent. Panhandle's transportation component included its regulated rate of return which was premised on Panhandle being able to meet a projected level of throughput. *See Maryland People's Counsel v. F.E.R.C.*, 761 F.2d 768, 776 (D.C. Cir. 1985).

most expensive of fifteen major interstate pipelines. The captive consumers of one LDC alone paid Panhandle overcharges for gas in excess of fifty-million dollars ($50,000,000). Moreover, because Panhandle's gas price was so high, captive consumers purchased less of it.

As a result of Panhandle's conduct, the output of gas available for the Central Illinois market was restricted because independent producers devoted their time and resources to areas accessible to pipelines other than Panhandle. Independent producers were prevented from selling even one molecule of their inexpensive gas to the captives during this period.

From 1983 through 1987, Panhandle possessed the highest rate of return among major pipelines, and did not absorb a single dollar of gas cost liability through lower profits. Panhandle paid dividends to its shareholders of approximately one hundred million dollars ($100,000,000) per year during this period.

C. Course Of Proceedings And Disposition Below.

In February, 1984 the State filed the instant action against Panhandle alleging violations of Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2 (1988), and Sections 3(3) and 3(4) of the Illinois Antitrust Act, Ill.Rev.Stat. ch. 38, §60-3 (1989).

After a bench trial, the district court found Panhandle had monopoly power in both the transmission and gas sales markets within Central Illinois. It also held that from 1983 through 1987 consumers wanted to purchase gas separate from transportation. (App. B-113) The district court found

that Panhandle intentionally[3] used its "control over the exclusive pipeline delivery system into the Central Illinois Market" to foreclose competition on the merits in gas sales by excluding its competitors and denying captive customers access to competitively priced gas supplies. (App. B-85). In examining the challenged conduct, the district court concluded that Panhandle had also engaged in segmentation of its market and price discrimination, and self-dealing with Trunkline. (App. B-173-74).

Panhandle did so, the court found, in order to maintain its ability to force captive customers to pay it a supercompetitive price for its gas. (App. B-190). The court observed that a further effect of this conduct was a reduction in the amount of gas available to consumers due to producers' decisions not to drill in areas served exclusively by Panhandle and in the amount of gas purchased by consumers. (App. B-79; B-136).

The court found that Panhandle's foreclosure of competition resulted from its business judgments and not because of any regulatory requirement. Accordingly, it held there was no regulatory justification for Panhandle's conduct. (App. B-226).

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[3] The district court relied on several of Panhandle's internal documents that reflected Panhandle's intent to "refuse to transport any third party gas into [a customer's] facility, even if a plant closing were to occur"; "create maneuvering room to deal with our producers and our customers, while not penalizing our shareholders"; "don't let LDC buy cheap gas for system supply to offset our sales"; "organize effort to hold others out of our market"; "[don't] give producers reason to believe we are giving away a captive market"; "split pipeline to provide several separate services with different supplies and prices"; "no enduser transport — keep pressure on LDCs to maintain load". (App. B-190).

The district court also rejected Panhandle's business justification defense based on Panhandle's contention that its conduct was motivated by a concern over take or pay exposure. The court found that this was merely a concern over potential lost profits, a business justification not valid under *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973). (App. B-224). The court found that Panhandle did not absorb a single dollar of take or pay costs, and that the entire cost of Panhandle's business judgments after 1978 in incurring take or pay was passed on to customers and not absorbed by shareholders of either Panhandle or Trunkline. (App. B-164). The court concluded that Panhandle's conduct did not fall within the recognized business justification defense because it "did nothing to promote lower costs, efficiency, innovation or better service" in gas sales. (App. B-225).

The court held that although Panhandle engaged in anticompetitive conduct, that conduct was not "willful" because it was put into action through use of a legitimate tool; the G tariff. (App. B-190). The court concluded that it was Panhandle's rights under the G tariff that entitled it to impair competition, and that absent the G tariff Panhandle's conduct may well have constituted willful maintenance of monopoly power. (App. B-190).

The Seventh Circuit disregarded the district court's findings and analysis, but affirmed its decision. (App. A-20). It held Panhandle had a legitimate business justification for its conduct because Panhandle was motivated by a desire to avoid take or pay liability and not by a desire to exclude competition in gas sales; Panhandle was merely enforcing its rights under the G tariff; and Panhandle did not extract a monopoly profit in gas sales but only insured recovery of its rate of return. (App. A-25, 30-31). To the court below this legitimate business justification negated the possibility that Panhandle acted with anticompetitive intent. (App. A-24).

REASONS FOR GRANTING THE WRIT

Summary of Argument

This petition raises important issues of federal antitrust law: (1) whether a regulated monopolist that uses its bottleneck facility in a related unregulated market to foreclose competition on the merits resulting in the consumer's choice being limited to only the monopolist's inferior product, has a recognized business justification if the monopolist's actions were motivated by a desire to protect its corporate profits and were put into effect by adherence to a filed tariff, and (2) whether the proper focus of an antitrust analysis is to determine whether the challenged conduct promotes competition and maximizes consumer satisfaction or instead is to decide the fairness of requiring a regulated monopolist to compete in a related unregulated market where it does not have a competitive advantage on the merits.

There is no dispute in this case that Panhandle's gas was an inferior product. The court below held that Panhandle had a legitimate business justification under the antitrust laws for forcing its captive consumers to buy that inferior product, however, because it was motivated by the business reason of avoiding its take or pay exposure. For the court below, a business justification was any business decision that was "objectively reasonable" from the perspective of a profit-maximizing monopolist. The court concluded that Panhandle did not have to compete in gas sales with independent producers, by foregoing its "rights" under the G tariff, where to do so would not allow Panhandle to maximize its rate of return.

In so holding, the Seventh Circuit created a new standard for what constitutes a business justification under the antitrust laws, contrary to the Court's decisions in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985), and *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973). In *Aspen* this Court made clear that the only proper business justification is based on proof by the monopolist that its conduct is efficient because ultimately it will result in a better product or service being available in the marketplace. In *Otter Tail*, the Court explained what is *not* a legitimate business justification. There, the Court held that the mere promotion of corporate self-interest, through means that do not promote competition, is not justified.

The Seventh Circuit's new standard also results in the consideration of inappropriate factors under the balancing test of the rule of reason as enunciated in *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984). Under the rule of reason analysis otherwise anticompetitive conduct can be excused only if after balancing its economic benefits and harms, the benefits to the market as a whole outweigh the harms.

Here, Panhandle introduced no evidence supporting a recognized business justification under the antitrust laws. It presented no proof that it lacked the capacity to transmit independent gas, or that any savings from the purchase of independent gas would be exceeded by take or pay liability payments allowed to be passed on to consumers, or that keeping independent gas out of the market in any way improved the quality or price of Panhandle's service or gas in the long run. Further, Panhandle presented no evidence that the disadvantages to consumers of having to purchase an inferior product were outweighed by the advantages provided by the joint packaging of its gas with transportation.

The court below's decision that Panhandle's conduct was a legitimate exercise of its power because it was put into effect by adherence to its filed tariff is in conflict with the Court's decisions in *Cantor v. Detroit Edison Co.*, 428 U.S. 579 (1976), *United States v. Loew's, Inc.*, 371 U.S. 38 (1962), *United States v. Griffith*, 334 U.S. 100 (1948), *Otter Tail*, and decisions of other circuits. These decisions emphasize that a monopolist's tariffs or contracts, even if valid when entered into, do not validate otherwise anticompetitive acts.

The Seventh Circuit's creation of an unprecedented "business justification" standard resulted directly from its failure to utilize the appropriate antitrust analysis. The court below ignored the impact of Panhandle's conduct on the gas sales market and instead focused exclusively on the effect competition would have on Panhandle's corporate profits. As a result of this focus, the court below concluded that it would have been unfair to make Panhandle compete. This decision ignores the directions of the Court in *National Society of Professional Engineers v. United States*, 435 U.S. 679 (1978), *Federal Trade Commission v. Indiana Federation of Dentists*, 476 U.S. 447 (1986), *Federal Trade Commission v. Superior Court of Trial Lawyers Association*, 110 S.Ct. 768 (1990), and appellate decisions on point, that an antitrust analysis must focus on the impact of the challenged conduct in the marketplace to determine whether it is efficient in that the conduct promotes—not precludes—competition. The decision also ignores the specific admonition of these cases that courts should not premise their antitrust analysis on whether it is fair for monopolists to compete. This is especially true where, not only the Sherman Act, but a specific mandate of Congress directs that competition exist in the particular industry.

In addition to these conflicts, this case raises important questions with respect to the viability and enforcement of the

antitrust laws. This is the first case to exonerate a monopolist for its anticompetitive activity on the rationale that a monopolist does not have to compete, if to do so would interfere with its ability to make corporate profits. Until now, the law has been that a monopolist that engaged in objectively anticompetitive activity, for which it offered no procompetitive reason, was liable under the antitrust laws. By destroying the certainty of this principle, the Seventh Circuit's decision encourages monopolists to engage in anticompetitive conduct, confident they will be excused if they were motivated by a self-serving business reason. The destruction of the principle will also deter victims of monopoly abuses and will result in antitrust injuries going unremedied.

The Court has recently granted certiorari in a case involving essential facility and tying claims in which the issue of what constitutes a legitimate business justification is raised. *Image Technical Services, Inc. v. Eastman Kodak Co.*, 903 F.2d 612, *cert. granted*, 111 S.Ct. 2823 (1991). The Court's handling of *Eastman Kodak* may well have implications with respect to the validity of the Seventh Circuit's interpretation of business justification. In the instant case, where those same questions arise, there is no dispute that the monopolist had dominant economic power in both the tying and tied product markets and that there were actual quantifiable anticompetitive effects on consumers.

Resolution of the issues raised by the petition is especially critical to industries in the process of being deregulated. A monopolist will be able to effectively thwart the legislative decision that competition is to take the place of regulation, if it can wait to compete and can continue to control the deregulated market until it is put on what it perceives to be a level playing field with its competitors. Similarly, potential competitors will not accept the invitation of deregulation to compete if monopolists can bar their entry into the market

through continued enforcement of practices and procedures developed in the prior regulatory framework.

The issues in this case are particularly important because the decision below has deprived the 300,000 residential and commercial consumers of the plaintiff class, who were the victims of Panhandle's challenged conduct, of a remedy. The Seventh Circuit held, pursuant to *California v. ARC America Corp.*, 490 U.S. 93 (1989), that these plaintiffs have the right to seek a remedy under their state antitrust claims. In assessing those claims the Seventh Circuit relied entirely on a federal antitrust analysis, as there was no conflict in the substantive provisions of the federal and state antitrust laws.

Here, the district court found that Panhandle had monopoly power, that it exercised that power unconstrained by regulation to exclude competitors in gas sales and that the effect of that conduct was to impair competition and to force consumers to pay a supercompetitive price for gas. The court expressly held that Panhandle's conduct did nothing to promote superior service, lower costs, or improved efficiency to consumers. (App. B-225). Yet because the Seventh Circuit set a new standard for business justification, it found that Panhandle's conduct was not anticompetitive. If the Seventh Circuit had applied the correct legal standard to the district court's findings of fact,[4] it would have concluded that overwhelming evidence existed that Panhandle was liable under the antitrust laws for monopolization, denial of access to an essential facility, monopoly leveraging and tying.

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[4] *See United States v. General Motors Corp.*, 384 U.S. 127 (1966); *United States v. Singer Manufacturing Co.*, 374 U.S. 174 (1963).

I. THE COURT OF APPEALS' DECISION AS TO WHAT CONSTITUTES A BUSINESS JUSTIFICATION UNDER THE ANTITRUST LAWS CONFLICTS WITH THIS COURT'S DECISIONS IN *ASPEN, JEFFERSON PARISH, OTTER TAIL, CANTOR, GRIFFITH* AND *LOEW'S*.

The decision below is directly contrary to the Court's rulings in *Aspen, Jefferson Parish, Otter Tail, Cantor, Griffith, Loew's,* and decisions in other appellate circuits, in that it creates an unprecedented standard for what constitutes legitimate business justifications for otherwise anticompetitive practices. The Court has established a standard for a business justification under the antitrust laws based on the proposition that the *likely effects* of what the defendant did, can justify what it did. The Seventh Circuit has established the new standard that the reasons *why* the defendant did what it did, can justify what it did.

A. The Decision Below Is In Conflict With *Aspen* and *Jefferson Parish*.

In *Aspen,* the Court clarified that not every maintenance of monopoly power is illegal. If the monopolist has a valid business reason for engaging in the challenged conduct, its conduct may not violate Section 2. In assessing whether the monopolist had such a reason, the intent of the monopolist is relevant, but only in deciding whether its conduct may properly be characterized as exclusionary. The test for determining whether conduct is exclusionary involves comparing the product that results from the challenged conduct with the product before, or absent, that conduct from the perspective of the consumer, competitor and monopolist. *Aspen,* 472 U.S. at 605.

Conduct is exclusionary if it results in consumers' choices being limited to an inferior product. The Court in

Aspen, however, recognized the monopolist's right to present evidence that, even though it might appear to consumers that the product is inferior, its actions, in fact, were taken to insure the availability in the long run of a higher quality, cheaper or more efficient product. *Id.* at 608-09. Creation of a superior product by a procompetitive means or method would be a valid business justification for the monopolist's conduct.

The before and after comparison of products required by *Aspen* is consistent with the rule of reason balancing test articulated by the concurring opinion in *Jefferson Parish.* That inquiry focused on the factors to be considered in judging whether a tying arrangement is an unreasonable restraint on competition. The Court first looked to whether the tie raised the price for the joint product, or decreased the sales volume of the tied product. The Court then examined whether the provision of the defendant's services in a joint package allowed it to operate more efficiently. A balancing test was then applied to assess if the economic benefits to competition outweighed the economic harms. *Id.* at 43-44 (concurring opinion). If they did, the restraint was reasonable and the defendant had a valid business reason for its conduct. If they did not, the conduct was exclusionary.

Contrary to both *Aspen* and *Jefferson Parish,* the court below never asked whether there were any procompetitive reasons from Panhandle's point of view that would counter the obvious anticompetitive effects that its conduct had on the captive consumers. Had the court applied the recognized standard it would have been forced to ask whether Panhandle's conduct, in excluding competitors in gas sales and in tying expensive gas to its transportation service, had a potentially beneficial impact on competition as a whole, and ultimately consumers. The obvious answer to this inquiry was that Panhandle's actions deprived the consumers of what

should have been their choice: to decide how much gas to purchase, from whom and at what price. Under the proper business justification standard, the effects of Panhandle's conduct would have prevented the conduct from being justified.

Other circuits have followed the Court's standard and have only recognized as a business justification a firm's engaging in conduct that could arguably result in the heightening of competition and a better product or service being provided to consumers. *Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield of Rhode Island*, 883 F.2d 1101, 1110-11 (1st Cir. 1989), *cert. denied*, 110 S.Ct. 1473 (1990) (insurance company's practice of lowering payments for medical services for insureds so that its costs would be competitive, benefits the market); *Metrix Warehouse, Inc. v. Daimler-Benz Aktiengesellschaft*, 828 F. 2d 1033, 1040-41 (4th Cir. 1987), *cert. denied*, 486 U.S. 1017 (1988); *Mozart Co. v. Mercedes-Benz of North America, Inc.*, 833 F.2d 1342, 1348-50 (9th Cir. 1987), *cert. denied*, 488 U.S. 870 (1988) (in both cases, the defendants contended that Mercedes' parts were of a higher quality than distributors' parts); *Eastman Kodak*, 903 F.2d at 618-20; (Kodak's repairmen were superior to repairmen in competing independent service organizations). The court below's standard conflicts in principle with these cases.

B. The Court Below's Standard Is Directly Contrary To The Court's Decision In *Otter Tail*.

The court below devised a business justification standard under which the trier of fact decides whether the defendant in engaging in the conduct was motivated by an objectively legitimate corporate business reason that would then justify the conduct even if it was exclusionary. Utilizing that standard, the court concluded that Panhandle's actions were justified because they were motivated by what Panhandle considered to be the valid corporate business reason of

protecting itself against the loss of profits. In applying this radical standard the Seventh Circuit stood the Court's decision in *Otter Tail* on its head, and ignored the express findings of the district court.

The business reason accepted by the Seventh Circuit as legitimate was Panhandle's desire to avoid the losses that would result if its expensive gas had to compete with the independents' cheaper gas. *Otter Tail* explicitly rejected such a reason as constituting a legitimate business justification defense holding that "the promotion of self interest alone does not . . . immunize otherwise illegal conduct." 410 U.S. at 380. *See also Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 50-51 (9th Cir. 1971), *cert. denied,* 405 U.S. 955 (1972) (tying of restaurant supplies to franchise to enhance defendant's revenues was not justified.).

Otter Tail did recognize the right of a firm to protect itself against its competitors by operating with "superior service, lower costs and improved efficiency." 410 U.S. at 380. The rationale of *Otter Tail* was that if the firm operates in such a manner, it will promote competition and at the same time competitors will be able to react to the competitive spur by developing their own improvements, to the benefit of the market.

The Seventh Circuit, contrary to *Otter Tail,* justified Panhandle's use of its G tariff and exclusive transmission service to bar independent producers from the gas sales market rather than having to compete. In so holding, the Seventh Circuit improperly allowed Panhandle to substitute objectively anticompetitive means for competition. The independents were both Panhandle's competitors in gas and its customers in transportation and therefore, could not react competitively to Panhandle's denial of access because they

were dependent on Panhandle for transportation. Panhandle's refusal to ship translated into the independents' inability to get their superior product to consumers with the consequence that competition within the relevant market was harmed.

The district court specifically found that Panhandle's conduct did nothing to promote competition and, citing *Otter Tail*, rejected Panhandle's business justification defense. The Seventh Circuit, however, concluded the district court had read *Otter Tail* too narrowly. Under the Seventh Circuit's reading of *Otter Tail*, if a firm can protect itself by having lower costs, it should also be able to protect itself by avoiding higher costs to itself. *Otter Tail*, however, expected a competing firm to have lower costs than its competitors. The Court in *Otter Tail* would not have sanctioned Panhandle's protection of its profitability by refusing to compete in order to pass on its higher costs in the form of a supercompetitive price. Thus, the Seventh Circuit's conclusion that Panhandle was justified in foreclosing competition in order to protect itself against corporate losses is directly contrary to *Otter Tail* and the district court's findings.

C. The Court Below's Decision That Panhandle's Conduct Was Legitimate Because It Was Put Into Effect By Adhering To Its Filed Tariff Conflicts With The Court's Decisions In *Cantor, Griffith, Otter Tail, Loew's* And With Circuit Decisions.

For the court below, an additional factor that validated Panhandle's conduct was that its conduct was put into action by Panhandle's enforcement of its "rights" under the G tariff. This holding is in conflict with the Court's holdings in *Cantor*, 428 U.S. at 595-601, *Loew's*, 371 U.S. at 52, *Otter Tail*, 410 U.S. at 378-79, *Griffith*, 334 U.S. at 108-10, and with the Fifth Circuit Court of Appeals' holding in *Poster Exchange, Inc. v. National Screen Service Corp.*, 431 F.2d 334, 336-40

(5th Cir. 1970), *cert. denied*, 401 U.S. 912 (1971), all of which support the proposition that a monopolist's adherence to its tariffs or contracts, even if legal when entered into, does not validate otherwise anticompetitive acts. The reasoning of these cases is that a monopolist is able to use its economic power to dictate the terms of its tariffs and contracts to the captive distributors and consumers. Use of these tariffs then is merely a reinforcement of that power and does not justify otherwise anticompetitive acts.

The G tariff was a result of Panhandle's monopoly power over the LDCs. The Seventh Circuit's assumption that the G tariff was an arms length agreement between equal parties was specifically rejected by the D.C. Circuit in *Associated Gas Distributors v. F.E.R.C.*, 824 F.2d 981, (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988). In *AGD* the D. C. Circuit noted that LDCs would not have entered into long term tariffs with pipelines were it not for the pipelines' monopoly power in transmission. It characterized those tariffs as being "vestiges of their monopoly power . . . " *Id.* at 1017.

Even if the G tariff was an arms length agreement between Panhandle and the LDCs, the captive consumers were never parties to that tariff. And if the LDCs were supposedly acting as the agents of the captives, it is clear that the LDCs had neither the ability nor the desire to protect consumers—and they did not. *State of Illinois ex rel. Hartigan v. Panhandle Eastern Pipe Line Co.*, 852 F.2d 891 (7th Cir.) *cert. denied*, 488 U.S. 986 (1988), ("its residential consumers had no good alternative to natural gas [of which Cilco was the sole purveyor] and Cilco's profit maximizing course of action was to allow its rates to them to rise by the exact amount its gas costs arose as a result of Panhandle's alleged overcharge."). The court below sanctioned a deal between two monopolists neither of whom was acting in the best interest of the captive consumers.

Another critical flaw in the court's reasoning that Panhandle's use of its G tariff was justified, was the court's belief that if Panhandle did not enforce its rights under the G tariff it would be helping its competitors. The court concluded that a monopolist has no such duty under the antitrust laws. This reasoning is inconsistent with a recent decision by the Ninth Circuit in *Alaska Airlines v. United Airlines*, 1991 U.S. App. LEXIS 25119 (9th Cir. Oct. 29, 1991). In *Alaska Airlines*, the court stressed the difference between a refusal to deal which merely inconveniences one's competitors and forces them to work harder to compete, and a refusal which eliminates competition completely. As the Ninth Circuit correctly observed, "When a firm's power to exclude rivals from a facility gives the firm the power to *eliminate* competition in a market downstream from the facility, and the firm excludes at least some of its competitors, the danger that the firm will monopolize the downstream market is clear." *Id.* at *28-*29. Here, Panhandle's refusal to grant access to independent gas producers was absolute and obliterated all chances of competition.

Further, the court below concluded that Panhandle excluded the independents not by its exclusive transmission service, but rather, by its G tariff. The court, however, wrongly assumed that the G tariff prevented the LDCs from purchasing new gas from the independents. Even if prior to the NGPA, Panhandle had lawfully derived monopoly power in gas sales by virtue of its monopoly power in transportation and the regulation of gas prices, it lost it when the NGPA was passed. In the NGPA Congress decreed that shipments of new gas were to be outside of FERC's regulatory and tariff jurisdictions. Thus, to the extent the LDCs purchased new gas, that gas was outside the scope of the G tariff. The only way then that Panhandle could continue to maintain its monopoly in new gas sales after the NGPA was through the abuse of its

dominant economic power in transportation. *Otter Tail*, 410 U.S. at 380.

D. The Court Below's Application Of Its Business Justification Standard To The Facts Was Premised On Erroneous Economic Assumptions.

In applying its motivation standard the Seventh Circuit pictured Panhandle in a completely different light than did the district court. Whereas the district court recognized Panhandle's and its corporate officers' "obvious indifference to the impact of their decisions on the 'little people' at the far end of the pipeline" (App. B-243), the Seventh Circuit saw Panhandle as an altruistic, energized knight dedicated to the quest of meeting the gas needs of the people of Peoria. In arriving at this view of Panhandle, the court below made erroneous economic assumptions.

Underlying the Seventh Circuit's concern about being fair to Panhandle was its assumption that Panhandle was acting as a disinterested middleman in purchasing gas with no incentive to force up the price of its gas. The court failed to recognize, however, that Panhandle had its own economic incentives for entering into the take or pay contracts. Panhandle made its profits solely on gas transmission. All Panhandle cared about was having the supply available, regardless of price, to maximize its throughput in times when gas supply was short. That Panhandle was insensitive to price at the time it entered into these contracts is evidenced by its failure to include market out clauses in any of the contracts. Such clauses, while guaranteeing supply, would have given Panhandle the option of not taking the gas if it was priced in excess of the market price. Further, many of Panhandle's take or pay contracts were entered into with its affiliates after deregulation, at NGPA ceiling prices, when gas had already become abundant and prices were low. Panhandle did not care if its gas was more expensive than the market price, as

long as it could continue to pass on its gas costs and those of its affiliates to its captive customers. Panhandle knew it would only be able to pass these high costs on, if the captive customers were prevented from buying from the independents. Thus, far from protecting the consumers, the take or pay contracts merely eliminated the risk to Panhandle of fluctuations in the market with respect to supply.

The court also erred in assuming Panhandle did not make monopoly profits on the sale of gas. While it is true that regulation allowed Panhandle only to pass on the exact price of its gas, Panhandle made profits on the sale of its delivered gas. Panhandle's gas price was above the competitive market price. In a competitive market, Panhandle would only be entitled to that market price. Every dollar Panhandle made on its delivered gas above that market price, in essence, was a monopoly profit in its transportation revenue. But for Panhandle's economic power in transportation it would not have been able to force consumers to pay above market for its gas. The effect of Panhandle's conduct was that it allowed Panhandle to avoid regulatory restraints on its transportation rate and increase its monopoly rents from the captives who had no alternatives to Panhandle's gas.

Contrary to the Seventh Circuit's view. Panhandle was out to make money, and it did. Panhandle's use of its dominant economic power, in a deregulated market, to avoid Congress' mandate that competition must replace regulation, prevented competition and created market distortions in gas production and price. While there is nothing wrong with a monopolist making money, Panhandle could not do so by destroying the competitive gas sales market and leaving the economically distressed consumers in Central Illinois, with what the district court found to be one choice: "heat or eat". (App. B-242).

II. THE COURT OF APPEALS' DECISION CONFLICTS WITH THIS COURT's DECISIONS IN *PROFESSIONAL ENGINEERS, INDIANA FEDERATION OF DENTISTS, SUPERIOR COURT TRIAL LAWYERS* AND CIRCUIT CASES, IN THAT IT UTILIZED AN IMPROPER FOCUS IN ITS ANTITRUST ANALYSIS.

The decision below is directly contrary to the Court's rulings in *Professional Engineers, Indiana Federation of Dentists, Superior Court Trial Lawyers,* and recent cases decided by the D.C. Circuit involving regulated industries. The court below erroneously applied an antitrust analysis that focused exclusively on the fairness of requiring a monopolist to compete rather than on the satisfaction of consumers and the promotion of competition as a means of facilitating the efficient allocation of resources.

A. The Decision Below Conflicts With The Court's Decisions In *Professional Engineers, Indiana Federation Of Dentists* And *Superior Court Trial Lawyers.*

The Seventh Circuit's creation of an unprecedented business justification standard was a direct result of its erroneous focus on the interests of Panhandle in avoiding competition in gas sales, to the exclusion of the interests of consumers and independent gas producers in the formation of a competitive gas market. Under the antitrust laws the focus is always on the impact of the challenged conduct on competition as a whole in the marketplace; not on what the court below focused, which was whether competition was good or bad from Panhandle's perspective.

This Court in *Professional Engineers* rejected the exact focus utilized by the Seventh Circuit. In *Professional Engineers,* the defendant argued that in its industry, engineers should not have to engage in competitive bidding because to

do so would encourage the lowering of costs through short cuts that would lead to an unsafe product. In rejecting this justification for a refusal to compete, the Court stated that in determining whether a restraint may be reasonable courts must "focus directly on the challenged restraint's impact on competitive conditions." *Professional Engineers*, 435 U.S. at 688. The Court noted that attacks on competition as being a threat to entities in the marketplace are essentially frontal assaults on the basic policy of the Sherman Act. The Court stated that the antitrust laws reflect Congress' judgment that competition, by granting consumers free choice among alternative offers, will ultimately produce not only lower prices, but also better goods and services. *Id.* at 695. *See Superior Court Trial Lawyers,* 110 S.Ct. at 775. This analysis was reaffirmed in *Indiana Federation of Dentists* where the Court stressed that a refusal to compete, "absent some countervailing procompetitive virtue" cannot be sustained. 476 U.S. at 459. Courts, therefore, are not to inquire whether in a particular industry it might not be a good idea to have competition; competition is always in the public interest.

The decision below rests on the proposition that the process of evolving from a regulated to a deregulated industry placed burdens on Panhandle that made it unfair to require Panhandle to compete, unless and until it was guaranteed that competing would not threaten its profitability. Thus, the court's improper focus allowed it to ignore the patently anticompetitive impact of Panhandle's conduct, which was to eliminate all competition in the gas sales market.

B. The Decision Below Conflicts In Principle With Decisions Of The D.C. Circuit With Respect To The Proper Focus Of An Antitrust Analysis Applied To The Conduct Of A Regulated Utility.

The court below's exclusive focus on the effect of competition on the monopolist has been rejected by several district

courts of appeals in cases involving regulated utilities. In those cases, application of the correct antitrust analysis focused on the promotion of competition through insuring that the utility, as a monopolist, did not subvert the underlying purpose of the applicable regulatory scheme.

In *Environmental Action, Inc. v. F.E.R.C.*, 939 F.2d 1057 (D.C. Cir. 1991) the D.C. Circuit considered whether the defendant could use its "bottleneck" in electricity transmission to foreclose the entry of its competitor in electrical sales where, absent such action, the competitor would have an advantage over it in sales. The D.C. Circuit stated that the purpose of antitrust policy "is not to make competitors equal or to avoid all forms of advantage . . . ". *Id.* at 1061. The court stated that competition is not valued for its own sake but because it is most likely to maximize consumer satisfaction.

The D.C. Circuit reasoned that even if the competitor had a competitive advantage, that advantage was the result of a Congressional mandate. Congress had made the policy choice to encourage the sale of electrical power by firms other than traditional utilities. Allowing the defendants to refuse access to the sales market would have the effect of repealing the congressional choice that there be competition. *Id.* at 1062. So here, Congress in enacting the NGPA decreed that there was to be competition in gas sales and Panhandle's action frustrated that intent.

The Seventh Circuit focused on the allocation of risks that occurred by virtue of Panhandle's contractual and tariff relationships. The court perceived competition as being unfair to Panhandle if it required a reallocation of those risks. The court was concerned that Panhandle's high cost gas would make it a loser. As *Environmental Action* teaches, however, the antitrust laws are not concerned with winners or losers, or whether one competitor has an advantage over

another, but with efficiency. Contrary to the Seventh Circuit's analysis, monopolists—or for that matter all competitors—are not guaranteed a level playing field before engaging in competition.

The decision below also conflicts with the D.C. Circuit's decisions in *Maryland People's Counsel v. F.E.R.C.*, 761 F.2d 768 (D.C. Cir. 1985 ("MPC I") *and Maryland People's Counsel v. F.E.R.C.*, 761 F.2d 780 (D.C. Cir. 1985) ("MPC II"). Both cases dealt with attempts by interstate pipelines, after the NGPA, to continue exercising their power in transportation to maintain their derivative power in gas sales over captive customers. The courts stated that an antitrust analysis must take into account the consequences to consumers of a pipeline's ability to segment its markets and engage in self-dealing with affiliates thereby allowing the pipelines to continue to extract "monopoly rents" from the captives. *Id.* at 785. *See also MPC I*, 761 F.2d at 776-77.

Instead of focusing on whether Panhandle's captive customers were being charged a supercompetitive price for gas, the court below focused on whether Panhandle was making monopoly profits. In *MPC II* the D.C. Circuit recognized that pipelines' gas prices were high because pipelines lacked the competitive spark to engage in cost-effective gas purchasing practices knowing they could force their captive customers to purchase their gas. *MPC II*, 761 F.2d at 784. Consumers do not care why they are paying a supercompetitive price for gas; only that they are. The appropriate antitrust analysis does not vary depending on whether the monopolist is trying to protect its profits in gas transportation from the effect of its having to absorb gas it purchased but could not resell, or is merely attempting to extort monopoly profits in gas sales. In either case, the focus should be on the impact of the monopolist's activity on competition. In this case, the court below

ignored that focus and engaged in an antitrust analysis that was contrary to the directives of the Court.

CONCLUSION

The State of Illinois' petition for a writ of certiorari should be granted.

Respectfully submitted,

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